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October 22, 2004

Mary L. Cottrell, Secretary  
Department of Telecommunication and Energy  
One South Station, 2<sup>nd</sup> Floor  
Boston, MA 02202

Re: D.T.E. 04-61 – Petition of Boston Edison Company and Commonwealth Electric Company for Approvals Relating to the Termination of Power Purchase Agreements with MASSPOWER

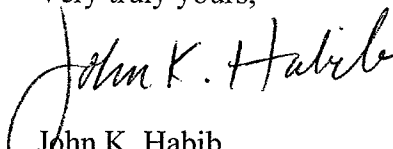
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Dear Secretary Cottrell:

Enclosed please find Boston Edison Company and Commonwealth Electric Company d/b/a NSTAR Electric's ("NSTAR Electric") responses to the record requests listed on the following page. Please note that attachments relating to several of these responses are confidential and are being filed under separate cover with the Hearing Officer and the Attorney General only.

Thank you for your attention to this matter.

Very truly yours,

  
John K. Habib

Enclosures

cc: Service List  
Joan Foster Evans, Hearing Officer (2)  
Colleen McConnell, Assistant Attorney General (2)

**RESPONSES ATTACHED**

RR-AG-1

RR-AG-2 **CONFIDENTIAL ATTACHMENT**

RR-DTE-1

RR-DTE-2 **CONFIDENTIAL ATTACHMENT**

Record Request AG-1 (Tr. 1, at 32-34, 65)

Please update the Company's original filing using the fall-2004 Henwood study, and update the original exhibits in NSTAR-BEC-GOL-2 through -8, NSTAR-COM-GOL-2 through -8 as necessary, and Exhibits NSTAR-RBH-5 and -6, as necessary.

Response

CEA and the Company understand that the Fall Henwood Forecast will become available on October 29, 2004. The Companies will supplement this response with the requested schedules as quickly as possible after receipt of the forecast.

Record Request AG-2 (Tr. 1, at 150-152)

Please provide a calculation showing a detailed explanation of the savings associated with each termination agreement without the securitization savings. Please provide the supporting references associated with these schedules.

Response

**CONFIDENTIAL ATTACHMENT**

There is only one Termination Agreement for the three existing PPAs (Exhibit NSTAR-1, Appendix A (**CONFIDENTIAL**)). It does not allocate the lump-sum termination payment among the existing PPAs, and therefore, the savings have not been separately calculated for each PPA. However, in an attempt to be responsive to this record request, the payment has been allocated for purposes of this response, in order to compute cost savings separately for each contract. The allocation of the buyout payment on Attachment RR-AG-2 **CONFIDENTIAL** was performed by first allocating the payment between the Boston Edison PPA and the two Commonwealth PPAs in proportions set forth in Exhibit NSTAR-GOL-2, "summary" page, line 1. The resulting Commonwealth portion of the payment was allocated between the two contracts based on the respective ratio of above-market costs.

Record Request DTE-1 (Tr. 1, at 34)

Please provide a copy of the Fall-2004 Henwood Forecast and an update on the savings calculations that incorporates the Fall 2004 Henwood Forecast and the updates from Exhibit DTE-1-13, the updated transaction cost, and Exhibit DTE-1-3, the updated fuel price and escalation of that fuel price.

Response

CEA and the Company understand that the Fall Henwood Forecast will become available on October 29, 2004. The Companies will supplement this response with a copy of the forecast and the requested schedules as quickly as possible after receipt of the forecast.

Record Request DTE-2 (Tr. 44-45, 66-67)

Please provide a recalculation of the underpayment of estimated tax in 25 percent installments on April 15<sup>th</sup>, June 15<sup>th</sup>, September 15<sup>th</sup>, and December 15<sup>th</sup>. Please provide more details on the methodology that allows the Company to pay at the end of the year rather than in quarterly installments. Please provide a copy of the IRS code that pertains to said recalculation.

Response

For illustration purposes only, the amount to be securitized using the Department's assumption regarding Federal tax payments being made in 25 percent installments on April 15<sup>th</sup>, June 15<sup>th</sup>, September 15<sup>th</sup>, and December 15<sup>th</sup> are shown in Attachment RR-DTE-2(a) **CONFIDENTIAL**. Attachment RR-DTE-2(a) **CONFIDENTIAL** recalculates the latest version of Exhibit NSTAR-GOL-2, which was submitted as Attachment DTE-1-13 (Supp) **CONFIDENTIAL** and incorporates all of the updates identified in Exhibit DTE-1-13 (Supplemental). Although Attachment RR-DTE-2(a) **CONFIDENTIAL** incorporates the Department's assumption regarding tax payments, it does not accurately reflect the tax impact of the securitization. In fact, NSTAR Electric will annualize its federal tax payments and the tax impact of the securitization will be as indicated using the annualization method.

Details on the methodology under which the Company pays at the end of the year rather than in quarterly installments is as follows:

Internal Revenue Code §6655(a) imposes an addition to tax for any underpayment of estimated tax. The amount of an underpayment is calculated based on each of the four required installments. The installments are due on the 15<sup>th</sup> of the fourth, sixth, ninth and twelfth months of the taxable year. Each required installment equals 25 percent of the required annual payment, which is 100 percent of the tax due on the return for the taxable year. §6655(d).

A corporation is allowed by §6655(e) to compute its required estimated tax installments using an annualized method if it results in a lower required estimated tax installment than that determined under §6655(d). The standard option for annualization is three months of taxable income for the installment due April 15, three months for June 15, six months for September 15, and nine months for the December 15 payment. Under the annualization method there is no underpayment penalty if the payment, plus any previous estimated payments for the year, total at least 100 percent of the amount required to be paid by annualizing taxable income.

Treasury Reg. §1.6655-2(d) requires an accurate determination of the estimated income and deductions for the respective interim period. A main theme of these regulations is that the interim period stands on its own, not unlike a short-tax-year return. Regulations proposed in 1984, but still not final (Prop. Reg. §1.6655-2(e)(1)), also require a reasonably accurate determination of the items of income, gain, loss, deduction and credit properly includible under the taxpayer's method of accounting for the respective interim period. But this regulation adds the general rule that prohibits deduction in an interim period any item that is not properly accruable in that period even if the item is property accruable by year-end.

Boston Edison has been on the lien-date method for property taxes for Federal income tax purposes since 1985, based on a change in accounting method filed with the Internal Revenue Service. The company has also filed an election in its Federal income tax return to adopt the recurring item exception of Code §461. These two unique factors combined allow the company to include in its annualization computation the entire property tax deduction for the year in the month of January. This methodology generally allows the company to pay its annual Federal income tax liability on December 15 and avoid additions to tax.

Excerpts from the cited statutes and regulations are set forth as Attachment RR-DTE-2(b).

**IRC, 2004-CODE-VOL, SEC. 6655. FAILURE BY CORPORATION TO PAY ESTIMATED INCOME TAX.**

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**SEC. 6655. FAILURE BY CORPORATION TO PAY ESTIMATED INCOME TAX.**

**6655(a) ADDITION TO TAX.** --Except as otherwise provided in this section, in the case of any underpayment of estimated tax by a corporation, there shall be added to the tax under chapter 1 for the taxable year an amount determined by applying --

**6655(a)(1)** the underpayment rate established under section 6621,

**6655(a)(2)** to the amount of the underpayment,

**6655(a)(3)** for the period of the underpayment.

**6655(b) AMOUNT OF UNDERPAYMENT; PERIOD OF UNDERPAYMENT.** --For purposes of subsection (a)

**6655(b)(1) AMOUNT.** --The amount of the underpayment shall be the excess of

**6655(b)(1)(A)** the required installment, over

**6655(b)(1)(B)** the amount (if any) of the installment paid on or before the due date for the installment.

**6655(b)(2) PERIOD OF UNDERPAYMENT.** --The period of the underpayment shall run from the due date for the installment to whichever of the following dates is the earlier --

**6655(b)(2)(A)** the 15th day of the 3rd month following the close of the taxable year, or

**6655(b)(2)(B)** with respect to any portion of the underpayment, the date on which such portion is paid.

**6655(b)(3) ORDER OF CREDITING PAYMENTS.** --For purposes of paragraph (2)(B), a payment of estimated tax shall be credited against unpaid required installments in the order in which such installments are required to be paid.

**6655(c) NUMBER OF REQUIRED INSTALLMENTS; DUE DATES.** --For purposes of this section --

**6655(c)(1) PAYABLE IN 4 INSTALLMENTS.** --There shall be 4 required installments for each taxable year.

**6655(c)(2) TIME FOR PAYMENT OF INSTALLMENTS.** --

<i>In the case of the following required installments:</i>	<i>The due date is:</i>
1st.....	April 15
2nd.....	June 15
3rd.....	September 15



4th.....December  
.....15.

**6655(d) AMOUNT OF REQUIRED INSTALLMENTS.** --For purposes of this section --

**6655(d)(1) AMOUNT.** --

**6655(d)(1)(A) IN GENERAL.** --Except as otherwise provided in this section, the amount of any required installment shall be 25 percent of the required annual payment.

**6655(d)(1)(B) REQUIRED ANNUAL PAYMENT.** --Except as otherwise provided in this subsection, the term "required annual payment" means the lesser of --

**6655(d)(1)(B)(i)** 100 percent of the tax shown on the return for the taxable year (or, if no return is filed, 100 percent of the tax for such year), or

**6655(d)(1)(B)(ii)** 100 percent of the tax shown on the return of the corporation for the preceding taxable year.

Clause (ii) shall not apply if the preceding taxable year was not a taxable year of 12 months, or the corporation did not file a return for such preceding taxable year showing a liability for tax.

**6655(d)(2) LARGE CORPORATIONS REQUIRED TO PAY 100 PERCENT OF CURRENT YEAR TAX.** --

**6655(d)(2)(A) IN GENERAL.** --Except as provided in subparagraph (B), clause (ii) of paragraph (1)(B) shall not apply in the case of a large corporation.

**6655(d)(2)(B) MAY USE LAST YEAR'S TAX FOR 1ST INSTALLMENT.** --Subparagraph (A) shall not apply for purposes of determining the amount of the 1st required installment for any taxable year. Any reduction in such 1st installment by reason of the preceding sentence shall be recaptured by increasing the amount of the next required installment determined under paragraph (1) by the amount of such reduction.

**6655(e) LOWER REQUIRED INSTALLMENT WHERE ANNUALIZED INCOME INSTALLMENT OR ADJUSTED SEASONAL INSTALLMENT IS LESS THAN AMOUNT DETERMINED UNDER SUBSECTION (d).**

**6655(e)(1) IN GENERAL.** --In the case of any required installment, if the corporation establishes that the annualized income installment or the adjusted seasonal installment is less than the amount determined under subsection (d)(1) (as modified by paragraphs (2) and (3) of subsection (d)) --

**6655(e)(1)(A)** the amount of such required installment shall be the annualized income installment (or, if lesser, the adjusted seasonal installment), and

**6655(e)(1)(B)** any reduction in a required installment resulting from the application of this paragraph shall be recaptured by increasing the amount of the next required installment determined under subsection (d)(1) (as so modified) by the amount of such reduction (and by increasing subsequent required installments to the extent that the reduction has not previously been recaptured under this subparagraph).

**6655(e)(2) DETERMINATION OF ANNUALIZED INCOME INSTALLMENT.** --

**6655(e)(2)(A) IN GENERAL.** --In the case of any required installment, the annualized income

installment is the excess (if any) of --

**6655(e)(2)(A)(i)** an amount equal to the applicable percentage of the tax for the taxable year computed by placing on an annualized basis the taxable income, alternative minimum taxable income, and modified alternative minimum taxable income --

**6655(e)(2)(A)(i)(I)** for the first 3 months of the taxable year, in the case of the 1st required installment,

**6655(e)(2)(A)(i)(II)** for the first 3 months of the taxable year, in the case of the 2nd required installment,

**6655(e)(2)(A)(i)(III)** for the first 6 months of the taxable year in the case of the 3rd required installment, and

**6655(e)(2)(A)(i)(IV)** for the first 9 months of the taxable year, in the case of the 4th required installment, over

**6655(e)(2)(A)(ii)** the aggregate amount of any prior required installments for the taxable year.

**6655(e)(2)(B) SPECIAL RULES.** --For purposes of this paragraph --

**6655(e)(2)(B)(i) ANNUALIZATION.** --The taxable income, alternative minimum taxable income, and modified alternative minimum taxable income shall be placed on an annualized basis under regulations prescribed by the Secretary.

**6655(e)(2)(B)(ii) APPLICABLE PERCENTAGE.** --

	<i>The applicable percentage is:</i>
<i>In the case of the following required installments:</i>	
1st.....	25
2nd.....	50
3rd.....	75
4th.....	100.

**6655(e)(2)(B)(iii) MODIFIED ALTERNATIVE MINIMUM TAXABLE INCOME.** --The term "modified alternative minimum taxable income" has the meaning given to such term by section 59A(b).

**6655(e)(2)(C) ELECTION FOR DIFFERENT ANNUALIZATION PERIODS.** --

**6655(e)(2)(C)(i)** If the taxpayer makes an election under this clause --

**6655(e)(2)(C)(i)(I)** subclause (I) of subparagraph (A)(i) shall be applied by substituting "2 months" for "3 months",

**6655(e)(2)(C)(i)(II)** subclause (II) of subparagraph (A)(i) shall be applied by substituting "4 months" for "3 months",

**6655(e)(2)(C)(i)(III)** subclause (III) of subparagraph (A)(i) shall be applied by substituting "7 months" for "6 months", and

**6655(e)(2)(C)(i)(IV)** subclause (IV) of subparagraph (A)(i) shall be applied by substituting "10 months" for "9 months".

**6655(e)(2)(C)(ii)** If the taxpayer makes an election under this clause --

**6655(e)(2)(C)(ii)(I)** subclause (I) of subparagraph (A)(i) shall be applied by substituting "5 months" for "3 months",

**6655(e)(2)(C)(ii)(II)** subclause (II) of subparagraph (A)(i) shall be applied by substituting "8 months" for "6 months",

**6655(e)(2)(C)(ii)(III)** subclause (III) of subparagraph (A)(i) shall be applied by substituting "11 months" for "9 months".

**6655(e)(2)(C)(iii)** An election under clause (i) or (ii) shall apply to the taxable year for which made and such an election shall be effective only if made on or before the date required for the payment of the first required installment for such taxable year.

**6655(e)(3) DETERMINATION OF ADJUSTED SEASONAL INSTALLMENT. --**

**6655(e)(3)(A) IN GENERAL.** --In the case of any required installment, the amount of the adjusted seasonal installment is the excess (if any) of --

**6655(e)(3)(A)(i)** 100 percent of the amount determined under subparagraph (C), over

**6655(e)(3)(A)(ii)** the aggregate amount of all prior required installments for the taxable year.

**6655(e)(3)(B) LIMITATION ON APPLICATION OF PARAGRAPH.** --This paragraph shall apply only if the base period percentage for any 6 consecutive months of the taxable year equals or exceeds 70 percent.

**6655(e)(3)(C) DETERMINATION OF AMOUNT.** --The amount determined under this subparagraph for any installment shall be determined in the following manner --

**6655(e)(3)(C)(i)** take the taxable income for all months during the taxable year preceding the filing month,

**6655(e)(3)(C)(ii)** divide such amount by the base period percentage for all months during the taxable year preceding the filing month,

**6655(e)(3)(C)(iii)** determine the tax on the amount determined under clause (ii), and

**6655(e)(3)(C)(iv)** multiply the tax computed under clause (iii) by the base period percentage for the filing month and all months during the taxable year preceding the filing month.

**6655(e)(3)(D) DEFINITIONS AND SPECIAL RULES.** --For purposes of this paragraph --

**6655(e)(3)(D)(i) BASE PERIOD PERCENTAGE.** --The base period percentage for any period of months shall be the average percent which the taxable income for the corresponding months in each of the 3 preceding taxable years bears to the taxable income for the 3 preceding taxable years.

**6655(e)(3)(D)(ii) FILING MONTH.** --The term "filing month" means the month in which the installment is required to be paid.

**6655(e)(3)(D)(iii) REORGANIZATION, ETC.** --The Secretary may by regulations provide for the determination of the base period percentage in the case of reorganizations, new corporations, and other similar circumstances.

**6655(e)(4) TREATMENT OF SUBPART F AND SECTION 936 INCOME. --**

**6655(e)(4)(A) IN GENERAL.** --Any amounts required to be included in gross income under section 936 (h) or 951(a) (and credits properly allocable thereto) shall be taken into account in computing any annualized income installment under paragraph (2) in a manner similar to the manner under which partnership income inclusions (and credits properly allocable thereto) are taken into account.

**6655(e)(4)(B) PRIOR YEAR SAFE HARBOR. --**

**6655(e)(4)(B)(i) IN GENERAL.** --If a taxpayer elects to have this subparagraph apply for any taxable year --

**6655(e)(4)(B)(i)(I)** subparagraph (A) shall not apply, and

**6655(e)(4)(B)(i)(II)** for purposes of computing any annualized income installment for such taxable year, the taxpayer shall be treated as having received ratably during such taxable year items of income and credit described in subparagraph (A) in an amount equal to 115 percent of the amount of such items shown on the return of the taxpayer for the preceding taxable year (the second preceding taxable year in the case of the first and second required installments for such taxable year).

**6655(e)(4)(B)(ii) SPECIAL RULE FOR NONCONTROLLING SHAREHOLDER. --**

**6655(e)(4)(B)(ii)(I) IN GENERAL.** --If a taxpayer making the election under clause (i) is a noncontrolling shareholder of a corporation, clause (i)(II) shall be applied with respect to items of such corporation by substituting "100 percent" for "115 percent".

**6655(e)(4)(B)(ii)(II) NONCONTROLLING SHAREHOLDER.** --For purposes of subclause (I), the term "noncontrolling shareholder" means, with respect to any corporation, a shareholder which (as of the beginning of the taxable year for which the installment is being made) does not own (within the meaning of section 958(a)), and is not treated as owning (within the meaning of section 958(b)), more than 50 percent (by vote or value) of the stock in the corporation.

**6655(e)(5) TREATMENT OF CERTAIN REIT DIVIDENDS. --**

**6655(e)(5)(A) IN GENERAL.** --Any dividend received from a closely held real estate investment trust by any person which owns (after application of subsection (d)(5) of section 856) 10 percent or more (by vote or value) of the stock or beneficial interests in the trust shall be taken into account in computing annualized income installments under paragraph (2) in a manner similar to the manner under which partnership income inclusions are taken into account.

**6655(e)(5)(B) CLOSELY HELD REIT.** --For purposes of subparagraph (A), the term "closely held real estate investment trust" means a real estate investment trust with respect to which 5 or fewer persons own (after application of subsection (d)(5) of section 856) 50 percent or more (by vote or value) of the stock or beneficial interests in the trust.

**6655(f) EXCEPTION WHERE TAX IS SMALL AMOUNT.** --No addition to tax shall be imposed under subsection (a) for any taxable year if the tax shown on the return for such taxable year (or, if no return is filed, the tax) is less than \$500.

**6655(g) DEFINITIONS AND SPECIAL RULES. --**

**6655(g)(1) TAX.** --For purposes of this section, the term "tax" means the excess of --

**6655(g)(1)(A)** the sum of --

**6655(g)(1)(A)(i)** the tax imposed by section 11 or 1201(a), or subchapter L of chapter 1, whichever applies,

**6655(g)(1)(A)(ii)** the tax imposed by section 55,

**6655(g)(1)(A)(iii)** the tax imposed by section 59A, plus

**6655(g)(1)(A)(iv)** the tax imposed by section 887, over

**6655(g)(1)(B)** the credits against tax provided by part IV of subchapter A of chapter 1.

For purposes of the preceding sentence, in the case of a foreign corporation subject to taxation under section 11 or 1201(a), or under subchapter L of chapter 1, the tax imposed by section 881 shall be treated as a tax imposed by section 11.

**6655(g)(2) LARGE CORPORATION. --**

**6655(g)(2)(A) IN GENERAL.** --For purposes of this section, the term "large corporation" means any corporation if such corporation (or any predecessor corporation) had taxable income of \$1,000,000 or more for any taxable year during the testing period.

**6655(g)(2)(B) RULES FOR APPLYING SUBPARAGRAPH (A). --**

**6655(g)(2)(B)(i) TESTING PERIOD.** --For purposes of subparagraph (A), the term "testing period" means the 3 taxable years immediately preceding the taxable year involved.

**6655(g)(2)(B)(ii) MEMBERS OF CONTROLLED GROUP.** --For purposes of applying subparagraph (A) to any taxable year in the testing period with respect to corporations which are component members of a controlled group of corporations for such taxable year, the \$1,000,000 amount specified in subparagraph (A) shall be divided among such members under rules similar to the rules of section 1561.

**6655(g)(2)(B)(iii) CERTAIN CARRYBACKS AND CARRYOVERS NOT TAKEN INTO ACCOUNT.** --For purposes of subparagraph (A), taxable income shall be determined without regard to any amount carried to the taxable year under section 172 or 1212(a).

**6655(g)(3) CERTAIN TAX-EXEMPT ORGANIZATIONS.** --For purposes of this section --

**6655(g)(3)(A)** Any organization subject to the tax imposed by section 511, and any private foundation, shall be treated as a corporation subject to tax under section 11.

**6655(g)(3)(B)** Any tax imposed by section 511, and any tax imposed by section 1 or 4940 on a private foundation, shall be treated as a tax imposed by section 11.

**6655(g)(3)(C)** Any reference to taxable income shall be treated as including a reference to unrelated business taxable income or net investment income (as the case may be).

In the case of any organization described in subparagraph (A), subsection (b)(2)(A) shall be applied by substituting "5th month" for "3rd month", subsection (e)(2)(A) shall be applied by substituting "2 months" for

"3 months" in clause (i)(I), the election under clause (i) of subsection (e)(2)(C) may be made separately for each installment, and clause (ii) of subsection (e)(2)(C) shall not apply. In the case of a private foundation, subsection (c)(2) shall be applied by substituting "May 15" for "April 15".

**6655(g)(4) APPLICATION OF SECTION TO CERTAIN TAXES IMPOSED ON S CORPORATIONS.** --In the case of an S corporation, for purposes of this section --

**6655(g)(4)(A)** The following taxes shall be treated as imposed by section 11:

**6655(g)(4)(A)(i)** The tax imposed by section 1374(a) (or the corresponding provisions of prior law).

**6655(g)(4)(A)(ii)** The tax imposed by section 1375(a).

**6655(g)(4)(A)(iii)** Any tax for which the S corporation is liable by reason of section 1371(d)(2).

**6655(g)(4)(B)** Paragraph (2) of subsection (d) shall not apply.

**6655(g)(4)(C)** Clause (ii) of subsection (d)(1)(B) shall be applied as if it read as follows:

**6655(g)(4)(C)** "(ii) the sum of --

**6655(g)(4)(C)(i)** "(i) the amount determined under clause (i) by only taking into account the taxes referred to in clauses (i) and (iii) of subsection (g)(4)(A), and

**6655(g)(4)(C)(ii)** "(ii) 100 percent of the tax imposed by section 1375(a) which was shown on the return of the corporation for the preceding taxable year."

**6655(g)(4)(D)** The requirement in the last sentence of subsection (d)(1)(B) that the return for the preceding taxable year show a liability for tax shall not apply.

**6655(g)(4)(E)** Any reference in subsection (e) to taxable income shall be treated as including a reference to the net recognized built-in gain or the excess passive income (as the case may be).

**6655(h) EXCESSIVE ADJUSTMENT UNDER SECTION 6425.** --

**6655(h)(1) ADDITION TO TAX.** --If the amount of an adjustment under section 6425 made before the 15th day of the 3rd month following the close of the taxable year is excessive, there shall be added to the tax under chapter 1 for the taxable year an amount determined at the underpayment rate established under section 6621 upon the excessive amount from the date on which the credit is allowed or the refund is paid to such 15th day.

**6655(h)(2) EXCESSIVE AMOUNT.** --For purposes of paragraph (1), the excessive amount is equal to the amount of the adjustment or (if smaller) the amount by which --

**6655(h)(2)(A)** the income tax liability (as defined in section 6425(c)) for the taxable year as shown on the return for the taxable year, exceeds

**6655(h)(2)(B)** the estimated income tax paid during the taxable year, reduced by the amount of the adjustment.

**6655(i) FISCAL YEARS AND SHORT YEARS.** --

**6655(i)(1) FISCAL YEARS.** --In applying this section to a taxable year beginning on any date other than January 1, there shall be substituted, for the months specified in this section, the months which correspond thereto.

**6655(i)(2) SHORT TAXABLE YEAR.** --This section shall be applied to taxable years of less than 12 months in accordance with regulations prescribed by the Secretary.

**6655(j) REGULATIONS.** --The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section.

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**FINAL-REG, FTS-REGS, §1.6655-2. Exceptions to imposition of the addition to the tax in the case of corporations**

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**§1.6655-2. Exceptions to imposition of the addition to the tax in the case of corporations**

(a) *In general.* —The addition to the tax under section 6655 will not be imposed for any underpayment of any installment of estimated tax if, on or before the date prescribed for payment of the installment, the total amount of all payments of estimated tax made equals or exceeds the amount which would have been required to be paid on or before such date if the estimated tax were the least of the following amounts —

(1) The tax shown on the return for the preceding taxable year, provided that the preceding taxable year was a year of 12 months and a return showing a liability for tax was filed for such year;

(2) An amount equal to a tax determined on the basis of the tax rates for the taxable year but otherwise on the basis of the facts shown on the return for the preceding taxable year and the law applicable to such year, in the case of a corporation required to file a return for such preceding taxable year; or

(3) An amount equal to 70 percent of the tax determined by placing on an annual basis the taxable income for —

(i) The first 3 months of the taxable year, in the case of the installment required to be paid in the 4th month,

(ii) Either the first 3 months or the first 5 months of the taxable year (whichever results in no addition being imposed), in the case of the installment required to be paid in the 6th month,

(iii) Either the first 6 months or the first 8 months of the taxable year (whichever results in no addition being imposed), in the case of the installment required to be paid in the 9th month, and

(iv) Either the first 9 months or the first 11 months of the taxable year (whichever results in no addition being imposed), in the case of the installment required to be paid in the 12th month.

The taxable income so determined shall be placed on an annual basis by first multiplying it by 12, and then dividing the resulting amount by the number of months in the taxable year for which the taxable income was so determined.

(4) In the case of a taxpayer whose taxable year consists of 52 or 53 weeks in accordance with section 441(f), the rules prescribed by §1.441-2(c) shall be applicable in determining, for purposes of subparagraph (1) of this paragraph, whether a taxable year was a year of 12 months and in determining, for purposes of subparagraph (3) of this paragraph, the commencement of the 3-month period, or the 3- or 5-month period, or the 6- or 8-month period, or the 9- or 11-month period, whichever is applicable. For example, if a taxable year begins on December 26, 1956, taxable income for the first 6 months of such year, for purposes of subparagraph (3) of this paragraph, shall be taxable income for the period beginning on December 26, 1956, and ending on June 30, 1957, since such taxable year is deemed to commence on January 1, 1957, under section 441(f).

(5) If the end of any accounting period employed by the taxpayer (e.g., any of either thirteen 4-week periods or four 13-week periods) does not correspond to the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month, period, taxable income shall be determined from the beginning of the taxable year to the close of the accounting period ending immediately before the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month, period and to the close of the accounting period within which such termination date falls. There shall be determined that portion of the difference between the two amounts of taxable income so determined which bears the same ratio to the total difference between such amounts as the number of days from the close of the first such accounting period to the close of such applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-



month, period bears to the total number of days between the termination dates of such two accounting periods. The portion of the difference between such amounts so determined shall then be added to (or subtracted from) taxable income determined to the close of the first such accounting period to determine taxable income for such applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month, period. For example, a taxpayer whose taxable year consists of 52 or 53 weeks in accordance with section 441(f) has a taxable year beginning on December 26, 1956, and thirteen 4-week accounting periods are employed in determining taxable income. Taxable income from December 26, 1956, to the close of the 4-week accounting period ending on June 11, 1957, is \$200,000, and taxable income from December 26, 1956, to the close of the 4-week accounting period ending on July 9, 1957, is \$228,000. Taxable income for the 6-month period ending on June 30, 1957, is \$219,000 ( $\$200,000 + (19 \times 28,000 \div 28)$ ).

(b) *Meaning of terms*

(1) For the purpose of the exceptions described in paragraph (a) of this section, the term "tax" means the excess of the tax imposed by section 11 or 1201(a), or subchapter L, chapter 1 of the Code, whichever is applicable, over the sum of \$100,000 plus the credits against tax allowed by sections 32, 33, and 38.

(2) The credits against the tax allowed by sections 32, 33, and 38, are --

(i) In the case of the exception described in paragraph (a)(1) of this section, such credits shown on the return for the preceding taxable year,

(ii) In the case of the exception described in paragraph (a)(2) of this section, such credits shown on the return for the preceding taxable year, except that if the amount of any such credit would be affected by any change in rates, the credits shall be determined by reference to the rates applicable to the current taxable year, and

(iii) In the case of the exception described in paragraph (a)(3) of this section, such credits computed under the law and rates applicable to the current taxable year.

The provisions of subdivision (ii) of this subparagraph may be illustrated by the following example:

*Example.* Assume that during the taxable year within which the normal tax rate in section 11 changes from 30 percent to 25 percent, corporation X has an underpayment of estimated tax. One-fourth of the taxable income of corporation X for the taxable year preceding that in which such underpayment occurs was from sources within foreign country Y. The return of corporation X for such preceding year shows taxable income of \$325,000 and a tax, without regard to any credits, of \$163,500. The credit allowed by section 33 on account of taxes paid to foreign country Y may not exceed one-fourth of such amount, or \$40,875, under section 904. The tax for the preceding year, computed by using the rates applicable to the year during which the underpayment occurs, would be reduced to \$147,250 and the limitation under section 904 on the credit allowed under section 33 for taxes paid to foreign country Y would be reduced to \$36,812.50, for purposes of determining the applicability of the exception described in paragraph (a)(2) of this section. Therefore, the exception described in paragraph (a)(2) of this section will be applicable if, on or before the date prescribed for such payment, the total amount paid by corporation X equals or exceeds the amount which would have been required to be paid by such date if the estimated tax were \$10,437.50 ( $\$147,250 \text{ less } (\$100,000 \div \$36,812.50)$ ).

(3) For the purpose of the exceptions described in paragraph (a)(1) and (2) of this section, the term "return for the preceding taxable year" means the income tax return for such year which is required by section 6012(a)(2).

(c) *Examples.* --The application of the exceptions to the imposition of the addition to tax may be illustrated by examples employing the following statement of facts:

Statement of Facts

Y, a corporation reporting on a calendar year basis, filed a declaration on April 15, 1965, showing an estimated

tax of \$47,100 for its taxable year ending December 31, 1965. The first installment of 4 percent of the estimated tax or \$1,884 was paid with the filing of the declaration, the second installment in the same amount was paid on June 15, 1965, and the third and fourth installments of \$11,775 (25 percent of the estimated tax) each were paid on September 15, 1965, and December 15, 1965, respectively. Y reported a tax liability of \$175,900 on its return due March 15, 1966. There was an underpayment in the amount of \$241.20 on each of the first and second installment dates and \$1,507.50 on each of the third and fourth installment dates determined as follows:

(1)	Tax as defined in paragraph (b) of this section (\$175,900 - \$100,000) .....	\$75,900.00
(2)	70% of item (1) .....	
(3)	4% of item (2) .....	
(4)	Deduct amount paid on each of the first and second installment dates .....	
(5)	Amount of underpayment at each of the first and second installment dates (item (3) minus item (4)) .....	
(6)	25% of item (2) .....	
(7)	Deduct amount paid on each of the last two installment dates .....	
(8)	Amount of underpayment at each of the third and fourth installment dates (item (6) minus item (7)) .....	

The application of each exception described in paragraph (a) of this section is determined as follows:

(1) Assume Y reported a liability of \$158,000 on its return for the taxable year ending December 31, 1964. If the estimated tax were \$158,000 reduced by \$100,000, or \$58,000, the amount which would have been required to be paid on or before each of the first and second installment dates would be 4 percent of \$58,000, or \$2,320. The amount which would have been required to be paid on or before each of the third and fourth installment dates would be 25 percent of \$58,000, or \$14,500. Since these amounts exceed the corresponding amounts actually paid on each installment date (\$1,884 and \$11,775, respectively), the exception described in paragraph (a)(1) of this section does not apply.

(2) As the corporation tax rates under section 11 are different for the taxable years ending December 31, 1964, and December 31, 1965, the amount of tax determined under paragraph (a)(2) of this section and the amounts required to be paid on or before each installment date must be determined. The tax liability determined on the basis of the calendar year 1965 rates but on the basis of the calendar year 1964 return is \$151,900 and the estimated tax is \$151,900 less \$100,000, or \$51,900. The amount which would have been required to be paid on or before each of the first and second installment dates would be 4 percent of \$51,900, or \$2,076, and the amount which would have been required to be paid on or before each of the third and fourth installment dates would be 25 percent of \$51,900, or \$12,975. Since these amounts exceed the corresponding amounts actually paid on each installment date (\$1,884 and \$11,775, respectively), the exception described in paragraph (a)(2) of this section does not apply.

(3) Y determined that its taxable income for the first 3, 5, 6, 8, 9, and 11 months was \$87,500, \$155,000, \$185,000, \$246,000, \$288,000, and \$341,000, respectively. The income for each period is annualized as follows:

$$\begin{aligned} \$87,500 \times 12 \div 3 &= \$350,000 \\ \$155,000 \times 12 \div 5 &= \$372,000 \end{aligned}$$

$$\begin{aligned}
 \$185,000 \times 12 \div 6 &= \$370,000 \\
 \$246,000 \times 12 \div 8 &= \$369,000 \\
 \$288,000 \times 12 \div 9 &= \$384,000 \\
 \$341,000 \times 12 \div 11 &= \$372,000
 \end{aligned}$$

To determine whether the installment payment made on April 15, 1965, equals or exceeds the amount which would have been required to be paid if the estimated tax were equal to 70 percent of the tax computed on the annualized income for the 3-month period, the following computation is necessary:

	<i>3 months</i>
(1) Annualized income .....	\$350,000.00
(2) Tax on item (1) reduced by \$100,000 .....	61,500.00
(3) 70 percent of item (2) .....	43,050.00
(4) 4 percent of item (3) .....	1,722.00

To determine whether the installment payments made on or before June 15, 1965 equal or exceed the amount which would have been required to be paid if the estimated tax were equal to 70 percent of the tax computed on the annualized income for either the 3- or 5-month period, the following computation is necessary:

	<i>3 months</i>	<i>5 months</i>
(1) Annualized income .....	\$350,000.00	\$372,000.00
(2) Tax on item (1) reduced by \$100,000 .....	61,500.00	72,060.00
(3) 70 percent of item (2) ...	43,050.00	50,442.00
(4) 8 percent of item (3) ...	3,444.00	4,035.36

To determine whether the installment payments made on or before September 15, 1965, equal or exceed the amount which would have been required to be paid if the estimated tax were equal to 70 percent of the tax computed on the annualized income for either the 6- or 8-month period, the following computation is necessary:

	<i>6 months</i>	<i>8 months</i>
(1) Annualized income .....	\$370,000.00	\$369,000.00
(2) Tax on item (1) reduced by \$100,000 .....	71,100.00	70,620.00
(3) 70 percent of item (2) ...	49,770.00	49,434.00
(4) 33 percent of item (3) ...	16,424.10	16,313.22

To determine whether the installment payments made on or before December 15, 1965, equal or exceed the amount which would have been required to be paid if the estimated tax were equal to 70 percent of the tax computed on the annualized income for either the 9- or 11-month period, the following computation is necessary:

	<i>9 months</i>	<i>11 months</i>
(1) Annualized income .....	\$384,000.00	\$372,000.00
(2) Tax on item (1) reduced by \$100,000 .....	77,820.00	72,060.00

(3) 70 percent of item (2) ...	54,474.00	50,442.00
(4) 58 percent of item (3) ...	31,594.92	29,256.36

The total amounts of all payments of estimated tax actually paid on or before the installment dates of April 15, 1965, June 15, 1965, September 15, 1965, and December 15, 1965, are \$1,884, \$3,768, \$15,543, and \$27,318, respectively. Since the total amounts of estimated tax actually paid on the first and second installment dates (April 15, 1965, and June 15, 1965) exceed the amounts required to be paid on such dates if the estimated tax were 70 percent of the tax determined by placing on an annualized basis the taxable income for the first 3 months of the taxable year, the exception described in paragraph (a)(3) of this section applies and no addition to tax will be imposed for the installments paid on April 15, 1965, and June 15, 1965. However, since the total amount of all payments of estimated tax actually paid on or before the third and fourth installment dates (September 15, 1965, and December 15, 1965) does not equal or exceed the applicable alternative amounts, the addition to the tax with respect to the underpayment of the September 15, 1965, and December 15, 1965, installments must be imposed.

(d) *Determination of taxable income for portion of taxable year.* —In determining the applicability of the exception described in paragraph (a)(3) of this section, there must be an accurate determination of the amount of income and deductions for the appropriate period, that is, for the first 3, 5, 6, 8, 9, or 11 months of the taxable year. See paragraph (d)(1) of §1.6654-2 for a description of a similar requirement with respect to individuals. [Reg. §1.6655-2.]

[T.D. 6267, 11-13-57. Amended by T.D. 6293, 5-20-58; T.D. 6768, 11-3-64 and T.D. 8996, 5-16-2002.]

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*Federal Tax Service Explanations:*

**1.6655-2(A)(4)**

FTS §P:6.61[3]

**1.6655-2(A)(5)**

FTS §P:6.61[3]

**1.6655-2(D)**

FTS §P:6.61[2]

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**PROP-REG, FTS-REGS, §1.6655-2. Exceptions to imposition of the addition to the tax in the case of corporations.**

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**§1.6655-2. Exceptions to imposition of the addition to the tax in the case of corporations.**

**Estimated Tax: Corporations.** --Reproduced below are the texts of proposed Reg. §§1.6655-4 and 1.6655-5 and proposed amendments of Reg. §§1.6655-1, 301.6655-1, 1.6655-2, 1.6655-3 and 1.6655-6 (published in the Federal Register on March 26, 1984).

Par. 6. Section 1.6655-2 is revised to read as follows:

**§1.6655-2. Exceptions to imposition of the addition to the tax in the case of corporations**

(a) *In general.* --The addition to the tax under section 6655 will not be imposed for any underpayment of any installment of estimated tax if, on or before the date prescribed for payment of the installment, the total amount of all payments of estimated tax made equals or exceeds the amount which would have been required to be paid on or before such date if the estimated tax were the least of the following amounts --

(1) The amount of tax shown on the return for the preceding taxable year, provided that the preceding taxable year was a year of 12 months and a return showing a liability for tax was filed for such year;

(2) An amount equal to a tax determined on the basis of the tax rates for the taxable year but otherwise on the basis of the facts shown on the return for the preceding taxable year and the law applicable to such year, in the case of a corporation required to file a return for such preceding taxable year; or

(3) An amount equal to 90 percent (80 percent in the case of a taxable year beginning on or before December 31, 1982) of the tax determined by placing on an annual basis for the taxable income for --

(i) The first 3 months of the taxable year, in the case of the installment required to be paid in the 4th month,

(ii) Either the first 3 months or the first 5 months of the taxable year (whichever results in no addition being imposed), in the case of the installment required to be paid in the 6th month,

(iii) Either the first 6 months or the first 8 months of the taxable year (whichever results in no addition being imposed), in the case of the installment required to be paid in the 9th month, and

(iv) Either the first 9 months or the first 11 months of the taxable year (whichever results in no addition being imposed), in the case of the installment required to be paid in the 12th month.

The taxable income so determined shall be placed on an annual basis by first multiplying it by 12, and then dividing the resulting amount by the number of months in the taxable year for which the taxable income was so determined.

(b) *Special rules*

(1) In the case of a taxpayer whose taxable year consists of 52 or 53 weeks in accordance with section 441(f), the rules prescribed by paragraph (b) of §1.441-2 shall be applicable in determining --

(i) Whether a taxable year was a year of 12 months for purposes of paragraph (a)(1) of this §1.6655-2, and

(ii) When the 3-month period, or the 3- or 5-month period, or the 6- or 8-month period, or the 9- or 11-month period (whichever is applicable) commences for purposes of paragraph (a)(3) of this

§1.6655-2. For example, if a taxable year begins on December 26, 1982, taxable income for the first 6 months of such year, for purposes of paragraph (a)(3) of this §1.6655-2, shall be taxable income for the period beginning on December 26, 1982, and ending on June 30, 1983, since such taxable year is deemed to commence on January 1, 1983, under section 441(f).

(2) If the end of any accounting period employed by the taxpayer (e.g., any of either thirteen 4-week periods or four 13-week periods) does not correspond to the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period, taxable income for the applicable period shall equal --

$$(a + (b \times c + d)),$$

where

a = taxable income from the beginning of the taxable year to the close of the accounting period ending immediately before the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period,

b = number of days from the close of the accounting period ending immediately before the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period to the close of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period,

c = taxable income from the beginning of the taxable year to the close of the accounting period within which the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period falls, minus a, and

d = number of days between the termination dates of the accounting period ending immediately before the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period and the accounting period within which the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month or 9- or 11 --month period falls.

Thus, for example, a taxpayer whose taxable year consists of 52 or 53 weeks in accordance with section 441(f) has a taxable year beginning on December 26, 1982, and thirteen 4-week accounting periods are employed in determining taxable income. Taxable income from December 26, 1982, to the close of the 4-week accounting period ending on June 11, 1983, is \$200,000, and taxable income from December 26, 1982, to the close of the 4-week accounting period ending on July 9, 1983, is \$228,000. Under the provisions of this paragraph (b)(2), taxable income for the 6-month period ending on June 30, 1983, is \$219,000 (i.e.,  $(\$200,000 + (19 \times 28,000 + 28))$ ).

(c) *Meaning of terms*

(1) *Meaning of term "tax".* --For the purpose of the exceptions described in paragraph (a) of this section, the term "tax" means the excess of --

(i) The tax imposed by section 11 or 1201(a), or subchapter L of chapter 1 of the Code, whichever is applicable, over

(ii) The sum of --

(A) The credits against tax provided by part IV of subchapter A of chapter 1, plus

(B) [reserved].

For purposes of paragraph (a)(2) of this section, the amount of tax paid from recomputing a prior year's investment credit under section 47 is a fact shown on the return for the preceding taxable year and is included in computing the prior year's tax. For example, X Corporation timely filed its 1977 income tax

return. The return showed no taxable income, but it included an amount of tax from recomputing a prior year's investment credit. For 1978, X had taxable income and a liability for income tax. X was required to pay its tax in installments under section 6154, but made no installment payments. X is subject to the addition to tax for underpayment of estimated tax imposed by section 6655(a), because X failed to pay, on or before the prescribed installment due dates, an amount equal to the tax resulting from the recomputation of the prior year's investment credit.

(2) *Credits against tax.* --The credits against the tax allowed by part IV of subchapter A of chapter 1 are

(i) In the case of the exception described in paragraph (a)(1) of this section, such credits shown on the return for the preceding taxable year,

(ii) In the case of the exception described in paragraph (a)(2) of this section, such credits shown on the return for the preceding taxable year, except that if the amount of any such credits would be affected by any change in rates, the credits shall be determined by reference to the rates applicable to the current taxable year, and

(iii) In the case of the exception described in paragraph (a)(3) of this section, such credits computed under the law and rates applicable to the current taxable year.

The provisions of paragraph (c)(2)(ii) of this section are illustrated by the following example:

*Example.* Assume that during a taxable year within which the graduated tax rates in section 11 are lowered, Corporation X has an underpayment of estimated tax. One-fourth of the taxable income of Corporation X for the taxable year preceding that in which such underpayment occurs was from sources within foreign country Y and the remainder of the taxable income was from sources within the United States. The return of Corporation X for such preceding year shows taxable income of \$325,000 and a tax, without regard to any credits, of \$163,500. For such preceding year, Corporation X paid more taxes to foreign country Y than may be allowed as a credit under section 33 by reason of the limitation of section 904. The credit allowed by section 33 on account of taxes paid to foreign country Y may not, under section 904, exceed one-fourth of the tax without regard to any credits, or \$40,875. The tax for the preceding year, computed by using the rates applicable to the year during which the underpayment occurs, would be reduced to \$147,250, and the limitation under section 904 on the credit allowed under section 33 for taxes paid to foreign country Y would be reduced to \$36,812.50, for purposes of determining the applicability of the exception described in paragraph (a)(2) of this section. Therefore, the exception described in paragraph (a)(2) of this section will be applicable if, on or before the date prescribed for such payment, the total amount paid by Corporation X equals or exceeds the amount which would have been required to be paid by such date if the estimated tax were \$110,437.50 (\$147,250 less \$36,812.50).

(3) *Definition of return for the preceding taxable year.* --For the purpose of the exceptions described in paragraph (a)(1) and (2) of this section, the term "return for the preceding taxable year" means the income tax return for such year which is required by section 6012(a)(2). However, if an amended return has been timely filed, then the term "return for the preceding taxable year" means the income tax return as amended and as timely filed.

(d) *Examples.* --The application of the exceptions to the imposition of the addition to tax is illustrated by examples employing the following statement of facts:

#### STATEMENT OF FACTS

Y, a corporation which reports on a calendar year basis, expected that it would have an estimated tax liability of \$62,000 for its taxable year ending December 31, 1983. Y is not a "large corporation" (see section 6655(i) and §1.6655-4). Y paid four installments of estimated tax, each in the amount of \$15,500 (25 percent of \$62,000), on April 15, 1983, June 15, 1983, September 15, 1983, and December 15, 1983, respectively. Y reported a tax liability of \$88,900 on its return due March 15, 1984, with no credits against tax. There was an underpayment in the amount of \$4,502.50 on each of the four installment dates, determined as follows:

(1) Tax as defined in paragraph (c)(1) of this section	\$88,900.00
(2) 90% of item (1) .....	\$80,010.00
(3) Amount of estimated tax required to be paid on each installment (25% of \$80,010) .....	\$20,002.50
(4) Deduct amount paid on each installment date .....	\$15,500.00
(5) Amount of underpayment for each installment date .....	\$4,502.50
	=====

The application of each exception described in paragraph (a) of this section is determined as follows:

(1) Assume Y reported a liability of \$74,900 on its return for the taxable year ending December 31, 1982. If the exception described in paragraph (a)(1) of this section were to apply, the amount which would have been required to be paid on or before each of the four installment dates would be 25 percent of \$74,900, or \$18,725. Since this amount exceeds the amount actually paid on each installment date, \$15,500, the exception does not apply.

(2) Assume that the facts shown on the return for the previous year (1982) showed Y to have a taxable income of \$184,167 and no credits against tax. The amount of tax determined under paragraph (a)(2) of this section and the amounts required to be paid on or before each installment date are as follows: the tax liability on the basis of the 1983 rates but on the basis of the calendar year 1982 return is \$64,467; the amount which would have been required to be paid on or before each of the four installment dates is 25 percent of \$64,467, or \$16,116.75. Since this amount exceeds the amount actually paid on each installment date, \$15,500, the exception described in paragraph (a)(2) of this section does not apply.

(3) The total amount of all payments of estimated tax actually paid on or before the installment dates of April 15, 1983, June 15, 1983, September 15, 1983, and December 15, 1983, are \$15,500, \$31,000, \$46,500, and \$62,000, respectively. Assume Y determined that its taxable income for the first 3, 5, 6, 8, 9, and 11 months was \$45,000, \$90,000, \$105,000, \$145,000, \$160,000 and \$195,000 respectively. The income for each period is annualized as follows:

$$\$45,000 \times 12 \div 3 = \$180,000$$

$$\$90,000 \times 12 \div 5 = \$216,000$$

$$\$105,000 \times 12 \div 6 = \$210,000$$

$$\$145,000 \times 12 \div 8 = \$217,500$$

$$\$160,000 \times 12 \div 9 = \$213,333.33$$

$$\$195,000 \times 12 \div 11 = \$212,727.27$$

(i) To determine whether the installment payment made on April 15, 1983, equals or exceeds the amount which would have been required to have been paid if the estimated tax were equal to 90 percent of the tax computed on the annualized income for the 3-month period, the following computation is necessary:

	<i>3 months</i>
(1) Annualized income.....	\$180,000
(2) Tax on item (1).....	\$62,550
(3) 90% of item (2).....	\$56,295
(4) 25% of item (3).....	\$14,073.75



Since the total amount of estimated tax actually paid on the first installment date (*i.e.*, \$15,500) exceeds the amount required to be paid on this date if the estimated tax were 90 percent of the tax determined by placing on an annualized basis the taxable income for the first 3-month period, the exception described in paragraph (a)(3) of this section applies, and no addition to tax will be imposed for the installment paid on April 15, 1983.

(ii) To determine whether the installment payments made on or before June 15, 1982, equal or exceed the amount which would have been required to have been paid if the estimated tax were equal to 90 percent of the tax computed on the annualized income for either the 3- or 5-month period, the following computation is necessary:

	3 months	5 months
(1) Annualized income.....	\$180,000	\$216,000
(2) Tax on item (1).....	\$62,550	\$79,110
(3) 90% of item (2).....	\$56,295	\$71,199
(4) 50% of item (3).....	\$28,147.50	\$35,599.50

Since the total amount of estimated tax actually paid on the second installment date (*i.e.*, \$31,000) exceeds the amount required to be paid on such date if the estimated tax were 90 percent of the tax determined by placing on an annualized basis the taxable income for the first 3- or 5-month period for the taxable year, the exception described in paragraph (a)(3) of this section applies, and no addition to tax will be imposed for the installment paid on June 15, 1983.

(iii) To determine whether the installment payments made on or before September 15, 1983, equal or exceed the amount which would have been required to have been paid if the estimated tax were equal to 90 percent of the tax computed on the annualized income for either the 6- or 8-month period, the following computation is necessary:

	6 months	8 months
(1) Annualized income.....	\$210,000	\$217,500
(2) Tax on item (1).....	\$76,350	\$79,800
(3) 90% of item (2).....	\$68,715	\$71,820
(4) 75% of item (3).....	\$51,536.25	\$53,865

Since the total amount of estimated tax actually paid on or before the third installment date (*i.e.*, \$46,500) does not equal or exceed the amount required to be paid on this date if the estimated tax were 90 percent of the tax determined by placing on an annualized basis the taxable income for the first 6- or 8-month period, the exception described in paragraph (a)(3) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the September 15, 1983, installment unless another exception applies to this installment payment.

(iv) To determine whether the installment payments made on or before December 15, 1983, equal or exceed the amount which would have been required to have been paid if the estimated tax were equal to 90 percent of the tax computed on the annualized income for either the 9- or 11-month period, the following computation is necessary:

	9 months	11 months
(1) Annualized income.....	\$213,333.33	\$212,727.27
(2) Tax on item (1).....	\$77,883.33	\$77,604.54

(3) 90% of item (2).....	\$70,095	\$69,844.09
(4) 100% of item (3).....	\$70,095	\$69,844.09

Since the total amount of estimated tax actually paid on or before the fourth installment date (i.e., \$62,000) does not equal or exceed the amount required to be paid on such date if the estimated tax were 90 percent of the tax determined by placing on an annualized basis the taxable income for the first 9- or 11-month period, the exception described in paragraph (a)(3) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the December 15, 1983, installment unless another exception applies to this installment payment.

*(e) Determination of taxable income for portion of taxable year when using annualization exceptions*

(1) *In general.* —In determining the applicability of the exception described in paragraph (a)(3) of this section (relating to the annualization of income) and the exception described in §1.6655-3 (relating to annualization of income for corporations with seasonal income), there must be a reasonably accurate determination of the items of income, gain, loss, deduction, and credit properly includible under the taxpayer's method of accounting for the appropriate period, that is, for the first 3, 5, 6, 8, 9, or 11 months of the taxable year. Generally, deductions which are not properly accruable during an applicable installment period because all the events which fix the fact of a liability have not yet occurred or because the amount of the deduction cannot be estimated with reasonable accuracy are not taken into account in that period for purposes of the annualization exception, even if such amounts are accruable by the end of the taxable year.

*(2) Exception for recurring expenditures*

(i) When a taxpayer has a history of incurring a specific category of expense, which, while attributable to income earned throughout the year, has not become a fixed liability until the end of the taxable year, the taxpayer may take into account for each installment period the amount of such expense properly allocable to such period provided —

(A) The amount so allocated to a particular installment period is determinable with reasonable accuracy, and

(B) The amount of the item so allocated is properly deductible by the taxpayer during the taxable year under the taxpayer's method of accounting.

(ii) The provisions of paragraph (e)(2)(i) of this section may be illustrated by the following example:

*Example.* Corporation X, a calendar year taxpayer, uses the accrual method of accounting. X has historically adopted a program at the beginning of each taxable year which provides for the distribution of year-end cash bonuses to its employees. The aggregate amount of bonuses to be distributed is determined at the beginning of the taxable year. In accordance with this program, the amount of the bonus payable to each employee is to be determined by the management in December. Under the provisions of subparagraph (2)(i), X may allocate a portion of the total amount of such year-end bonus to each installment period since X can determine that amount with reasonable accuracy and the amount of the bonus is properly deductible during X's taxable year under its method of accounting.

(3) *Items that substantially impact taxable income but cannot be determined accurately by the installment due date.* —In determining the applicability of the annualization exceptions described in paragraph (a)(3) of this section and §1.6655-3, reasonable estimates may be made from existing data for items that substantially impact income when the amount of such items cannot be determined accurately by the installment due date. Examples of these items are the LIFO index for taxpayers using the dollar-value LIFO inventory method, the deferred gross profit for taxpayers with revolving charge accounts, intercompany adjustments for taxpayers that file consolidated returns, and the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes would be replaced at the end of the year. Thus, for example, reasonable estimates by a taxpayer using the dollar-value LIFO method of accounting would be made by interpolating from an available inflation index for the same months in the previous year

to calculate the cost of goods sold in the present period of less than a full taxable year if no reliable inflation index for the present period is available. See also §1.6654-2(d)(1) and (2).

(4) *Events arising after installment due date which were not reasonably foreseeable.* --Events arising subsequent to the installment due date which cause the taxpayer's computation of its taxable income for the short period to be understated will not result in a recomputation of its taxable income for the short period. The preceding sentence applies only if at the time the installment payment is made, based on all the facts and circumstances, it was not reasonably foreseeable that these subsequent events would occur. Thus, for example, assume that Congress enacts retroactively effective legislation which causes the taxable income for the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period to be understated. This event, which occurred after the applicable installment due date, will not result in a recomputation of a corporation's taxable income for the applicable installment period because such an event was unforeseeable.

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*Federal Tax Service Explanations:*

**1.6655-2(A)(4)**

FTS §P:6.61[3]

**1.6655-2(A)(5)**

FTS §P:6.61[3]

**1.6655-2(D)**

FTS §P:6.61[2]

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